VZCZCXYZ0058
OO RUEHWEB

DE RUEHQT #0533/01 1691457
ZNR UUUUU ZZH
O 171457Z JUN 08
FM AMEMBASSY QUITO
TO RUEHC/SECSTATE WASHDC IMMEDIATE 9028
INFO RUEHBO/AMEMBASSY BOGOTA PRIORITY 7609
RUEHCV/AMEMBASSY CARACAS PRIORITY 3073
RUEHLP/AMEMBASSY LA PAZ JUN 1100
RUEHPE/AMEMBASSY LIMA PRIORITY 2656
RUEHGL/AMCONSUL GUAYAQUIL PRIORITY 3623
RHMFIUU/DEPT OF ENERGY WASHINGTON DC PRIORITY

UNCLAS QUITO 000533

SENSITIVE
SIPDIS

DEPT FOR WHA/EPSC FAITH CORNEILLE

E.O. 12958: N/A
TAGS: ECON EPET ENRG EINV EC
SUBJECT: ECUADOR TO OFFER MORE FLEXIBILITY IN PETROLEUM NEGOTIATIONS

REFTEL A: QUITO 351
B: 07 QUITO 2277
C: QUITO 55

¶1. (U) Summary. The GOE has offered to restart contract renegotiations with petroleum companies that it froze in April 2008, with additional flexibilities for firms such as a lower state share of extra revenues and a one-year extension of participation contracts. In exchange, companies would need to drop arbitration demands and commit to increase investments, and switch to services contracts after a year. End Summary.

¶2. (U) Thursday evening, June 12, Petroleum and Mines Minister Galo Chiriboga, under instructions from President Correa, offered to restart contract renegotiations with petroleum companies which the GOE froze in April 2008 (ref A). The GOE would drop the government's share of "extraordinary revenues" from the current 99% to 70%, and continue participation contracts for one year before companies would have to switch to service contracts (where they would only be paid for services provided). In exchange, companies would need to withdraw their arbitration demands and agree to a new forum for future arbitrations (other than the World Bank's center for investment disputes), and commit to increase investment.

The Players

¶3. (U) Five companies operating in Ecuador have filed for international arbitration against the GOE, asserting that the requirement that companies share at least 50% of "extraordinary income" with the state (upped to 99% in October 2007, ref B) changes the terms of their contracts and makes operations unviable. They include the U.S. firm City Oriente, French company Perenco and its U.S. minority partner Burlington (part of ConocoPhilips), and Spanish company Repsol and one of its minority partners, U.S. Murphy Oil. Repsol was the most recent company to file for arbitration, in June 2008.

¶4. (U) Brazilian Petrobras and Chinese Andes Petroleum are the two remaining major petroleum companies affected by the law that have not yet filed for arbitration.

¶5. (SBU) After Correa suspended contract negotiations, the GOE floated a model services contact in early June. The oil companies we talked to rejected the draft as incomplete. For example, it failed to explain how the GOE would compensate the oil companies for either the investments they have made to date, or would undertake under a services contract.

New Proposal "A Step Forward"

¶6. (SBU) Repsol is one of the largest foreign petroleum companies operating in Ecuador. The head of Ecuador's Hydrocarbons Association believes that with Repsol's arbitration filing, the GOE finally realized its previous proposals were unacceptable and is taking the situation seriously. He says companies consider the current proposal "not good, but a step forward." A 70% share could be acceptable to companies depending on the base for calculating extraordinary revenues, and was a key element in the contract negotiations that were aborted in April. (Note: the comprehensive tax package passed at the end of 2007 established that new contracts would be subject to a 70% extraordinary revenue sharing requirement - ref C) However, he considers a one year contract extension too short for companies to invest and recoup their money before they must face an unknown services contract proposal (in the aborted contract negotiations, at least Repsol and its partners considered a longer term contract extension to be an important factor in their willingness to accede to additional revenue sharing). He reports that petroleum companies will meet with GOE negotiating teams to discuss contracts beginning the week of June 16.

Comment:

¶7. (SBU) The GOE move to restart contract renegotiations with petroleum companies appears to be a positive step forward, possibly brought on by the GOE need for additional petroleum revenue as foreign companies have halted investment this year. However, the many conditions required make it unlikely that firms would agree in full to the current proposal - dropping arbitration and promising to migrate in a year to an as-yet undefined services contract appear particularly problematic. Given the many twists and turns of petroleum renegotiations to date, it is unclear if the current proposal signals a serious new start by the GOE.

JEWELL